INTERNAL AUDIT

Criteria for Ratings of Audit Findings and Report

AUDIT FINDING RATINGS

An important step in audit activities is to evaluate the results of audit engagements. This may involve assessing and rating individual audit findings and their significance to and impact on internal operations, administrative and financial controls and achievement of business objectives. Rating individual audit findings allows Internal Audit to communicate the potential level of exposure or risk associated with not implementing corrective actions emanating from audit findings.

The ratings of the significance and impact of individual audit findings are categorized as follows:

- A – High
- B – Medium
- C – Low
- Potential Improvement Opportunities

Below are examples of deficiencies with which each rating classification might be associated. However, these conditions do not address every possible deficiency. Also not all conditions have to exist in order to result a particular rating. One condition can be the reason for the rating issued.

PRIORITY	DEFICIENCY IS CHARACTERIZED BY THE FOLLOWING CONDITION(S)
A - High	► Significant failure of key control passed under Risk Management Control (RMC) program ► Significant internal control weakness and significant risk exposure ► Significant policy or procedure exceptions ► Impairs ability to accomplish key business objectives ► Significant financial / management reporting errors / exceptions – loss, misstatement ► Significant unapproved management override or blatant disregard for Corporate policies or procedures ► Fraud or significant law or regulatory violations ► Significant potential loss – revenue, savings, efficiencies, improvements Senior management should initiate corrective actions, which should generally be completed within 3 months.
B - Medium	► Failure of noteworthy aspect of key control passed under RMC program ► Moderate internal control weakness and risk exposure ► Moderate policy or procedure exceptions ► Slows the delivery of business objectives ► Failures to develop or maintain appropriate policies & procedures for key areas ► Moderate financial / management reporting exceptions – loss, misstatement, errors, ► Moderate law or regulatory violations ► Moderate potential loss – revenue, savings, efficiencies, improvements Senior management should initiate corrective actions, which should generally be completed within 3 – 6 months.

C - Low

- Minor internal control weakness or limited potential loss – revenue, savings, efficiencies, improvements
- Minor law or regulatory violations or policy and procedure exceptions
- Procedural improvements, rather than a control weaknesses
- Minor financial / management reporting exceptions – loss, misstatement, errors

Department Head should initiate corrective actions, which should generally be completed within 6 - 12 months.

Potential Improvement Opportunities

- Internal audit reports may also include observations and findings related to potential improvement opportunities for management's consideration. Such findings are not considered to be issues or problems from an internal audit perspective and will not impact audit report ratings. These items will not be included or tracked as pending items.

Management response is not required.

AUDIT REPORT RATINGS

Audit report ratings are used to accomplish the following objectives:

- Provide management with an indication of relative overall competence with which functions reviewed by the audit were performed. Though the audit ratings provide a reasonable indication within the scoped work, they do not represent an absolute conclusion on the adequacy or effectiveness of internal controls.
- Measure change in performance of functions since the previous audit or RMC key control testing.
- Provide incentive to area management to improve their operations.
- Help to determine the frequency and extent of audit coverage that should be considered in future.

The criteria for overall audit ratings is intended to be used as a set of guidelines to support rating consistency, not as inflexible rules which must be interpreted literally. The Auditor's judgment is an essential ingredient of audit ratings and should take precedence over a literal interpretation of the guidelines. The ratings attempt to consider size and complexity of the audited unit. The audit report ratings are categorized as follows:

- 1- Good
- 2- Satisfactory
- 3- Needs Improvement
- 4 - Unsatisfactory.

Below are examples of control performance with which each overall rating classification might be associated. However, these conditions do not address every possible deficiency. Also not all conditions have to exist in order to result a particular rating. One condition can be the reason for the rating issued.

RATING — **OVERALL CONTROL PERFORMANCE IS CHARACTERIZED BY THE FOLLOWING CONDITION(S)**

1- Good — **Overall control performance meets expected level.**

- No high or medium priority observations.
- Very few low priority weaknesses with limited risk exposure.
- Comments in report require no response and relate to suggestions for improving efficiency, as opposed to improving internal controls.
- Clear demonstration that management has "best practices'' in at least two areas of controls. Some examples of such best practices are: demonstrated tone at the top and controls consciousness; timely disclosure to senior management and correction of significant control weaknesses / failures, structured and effective monitoring of key controls, documented and

effective clear lines of authorities (e.g., BU-specific DOAs); documented, updated and effective policies and procedures; internally monitored segregation of duties; solid cash management practices; expansion of RMC framework to develop process maps and detailed narratives of key controls.

2 - Satisfactory

Overall control performance is generally acceptable but does not consistently meet the expected level.

- Few medium or low priority observations.
- One, or possibly two, high priority observations which did not create a liability or loss to the company.
- Overall, not more than four medium or high priority observations. Management has given strong commitment for timely resolution of each.

3 – Needs Improvements

Overall control performance frequently does not meet the expected level.

- Two or possibly three high priority observations.
- Several medium priority observations.
- Observations, which require substantial effort (reorganization, time or resources) to correct in the normal course of business.
- Internal control weaknesses or other conditions which created substantial losses or liabilities for the company.
- Overall not more than eight medium or high priority observations. Management has given strong commitment for timely resolution of each.

2 – Unsatisfactory

Overall control performance is weak and falls well below the expected level.

- A repeat audit finding on a high risk item that was committed to be remediated or significant failure of a key control that was passed under RMC program.
- Observations that require significant efforts (reorganization, time or resources) to correct in the normal course of business.
- A high priority unresolved or repeated audit finding, which was previously reported as remediated and closed.
- Internal control weaknesses or other conditions which created significant losses or liabilities for the company.
- Occurrence of a fraud, accounting misstatement, management override, deliberate policy violation, together with a failure to disclose will result in an automatic unsatisfactory rating
- Unreasonably lengthy implementation timing for correction of high priority findings.
- Significant violations of law, regulations, or management override of important established controls.
- More than three high priority observations.
- Overall more than eight medium or high priority observations.

An "Unsatisfactory" rating would require a targeted follow-up review within six months to determine if appropriate progress had been made to correct problems and implement agreed audit actions.